

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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May 23, 2011

LEGEND

Company =

State =

Member =
1

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This responds to a letter dated February 17, 2011, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

Company was formed as a limited liability company under the laws of State on Date 1. On Date 2, Company's members executed an Amended and Restated Operating Agreement, which provided the members' shares with different rights to

distribution and liquidation proceeds. Company then timely filed a Form 8832, Entity Classification Election, changing Company's classification to an association taxable as a corporation effective Date 3. Not realizing that disproportionate distribution and liquidation rights created a second class of stock, or that having a second class of stock makes a corporation ineligible to elect to be taxed as an S corporation, Company and its members timely filed a Form 2553, Election by a Small Business Corporation, effective Date 3. During the taxable year ended on Date 4, Company made disproportionate distributions to its members in accordance with its operating agreement.

Soon after realizing that its operating agreement may have created a second class of stock, and during the taxable year ended on Date 4, Company and its members amended the operating agreement to remove the provisions creating the second class of stock. On Date 5, Company made a remedial distribution to Member 1, remedying the previous disproportionate distribution.

Company represents that there was no intent to make an invalid S corporation election. In addition, Company and Company's shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation that has more than one class of stock does not qualify as a small business corporation. A corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made by reason of a failure to meet the requirements of § 1361(b), (2) the Secretary determines that the circumstances resulting in the ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken so that the corporation is a small business corporation, and (4) the corporation for which the election was made and each person

who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f) agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

CONCLUSION

Based solely on the information submitted and the representations made by Company, we conclude that Company's election to be treated as an S corporation was not effective for Date 3 because it had more than one class of stock. We further conclude that the election was an inadvertent invalid election under § 1362(f). Therefore, Company will be treated as an S corporation beginning Date 3, and thereafter, unless Company's S corporation election otherwise terminates under § 1362(d). The disproportionate and remedial distributions described above made pursuant to the operating agreement will not terminate Company's S corporation election under § 1362(d), but must be given appropriate tax effect. This ruling is contingent on Company and its shareholders treating Company as an S corporation for the period beginning Date 3, and thereafter.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed as to whether Company otherwise meets the requirements to be an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Company's authorized representative.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: